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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

PERIODIC REPORTING (PROPOSAL THREE)	Docket No. RM2018-6

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO QUESTIONS 1-3 OF CHAIRMAN'S INFORMATION REQUEST NO. 1
(June 20, 2018)

The United States Postal Service hereby provides its responses to Questions 1-3 of Chairman's Information Request No. 1, issued June 13, 2018. The questions are stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

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Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 277-6333
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1. The Postal Service states "[u]nfortunately, the method of calculating volume variable costs for NSA products does not require computing the amount of volume variable cost per NSA product in specific cost pools." Petition at 15. Please confirm that the Postal Service constructs volume variable costs for negotiated service agreement (NSA) products using unit costs by function *(e.g.,* mail processing, delivery, transportation, and other) that are aggregated from cost pools, as described in Docket No. ARC2017, Library Reference USPS-FY17-30 and Library Reference USPS-FY17-NP27, December 29, 2017.

a. If confirmed, please discuss whether the ratio of NSA product volume variable costs to product-group volume variable costs for each function (applied to its respective cost pools) could be used instead of a single volume variable cost ratio. Please describe any potential obstacles to this approach.

b. If not confirmed, please explain how the unit costs by function are used in constructing volume variable costs for NSA products.

RESPONSE:

As explained in the petition, an approximation is required for calculating the incremental cost for NSA products, because the required data are not collected by the Postal Service's data systems. That is, within each product grouping (e.g., Priority Mail), there are no data on the proportions of the cost driver used by the different NSA products in each cost pool.[1] The petition proposes using the overall ratio of each NSA product's volume variable cost to the total product group's volume variable cost as an

[1] A cost pool is the most disaggregated level of cost analysis and incorporates a single cost generating relationship between its cost driver and cost. In many instances, a cost component will include a single cost pool. But in other cases, like in purchased highway transportation or city carrier delivery, a cost component will contain multiple cost pools. The incremental cost model functions at the level of the cost component. In those components with multiple cost pools, incremental cost is calculated for each cost pool, and then combined to find the component incremental cost.

approximation for the unknown ratio. Such an approximation relies upon the assumption that the relative driver proportions, within product groups, are common across cost pools.

This question proposes a less aggregated approximation than the approximation presented in the petition. The question thus raises the possibility of more accurate incremental cost calculation because the disaggregated approximation could, conceptually, account for differential use of cost drivers by function. That is, it would permit a given NSA product's proportion of the product group's cost driver to be different in, say, mail processing than in transportation. This has conceptual appeal, because the function-level assumption is less restrictive.[2]

However, significant computational difficulties would arise in application of the function-level approximation, and these difficulties make it impractical, if not impossible, to implement the approach. First, the function-level approximation implicitly assumes that there is a direct rollup from components to functions in the NSA calculations, and this is not the case. In other words, the function-level approach assumes that one can uniquely identify the set of components that constitute mail processing or city delivery, but in reality, many components are split among functions. Functional volume variable costs for NSA products are developed using piggyback factors, which incorporate both direct component costs (such as mail processing labor), and indirect component costs

[2] If it turned out that the cost driver ratios were the same across functions, then the function-level approximation would be identical to the one proposed in the petition.

(such as supervisors, space and equipment costs, or service wide benefits). A single indirect component may be split among multiple functions.

Thus, to calculate incremental cost using the function-level approximation, the existing functional volume variable NSA costs would somehow have to be deconstructed into a new set of component-level volume variable NSA costs. This would require developing a new NSA volume variable cost process, which could require developing a new and potentially more restrictive set of assumptions. For example, the 'Other Cost' function actually is a residual of remaining costs, and thus would need to be deconstructed into the remaining piggyback categories reported in USPS-FY17-NP19 and any remaining non-piggybacked component costs.

A further difficulty arises for those cost components that include multiple cost pools. For those components, costs are calculated below the level of the component, at the individual cost pool level. Even if it were the case that the functional costs could be successfully deconstructed into cost components, another set of assumptions would need to be developed to provide the NSA product volume variable costs for the relevant cost pools.

A final difficulty is due to the complexity of the NSA cost calculations for a large subset of NSAs. For example, some NSA contracts for a product group consist of multiple items, each with a separate unit cost, with each item requiring a separate calculation under the functional cost approach. This complexity imposes a high computational burden in attempting to implement the function-level approximation.

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Because of its theoretical potential to increase the accuracy of the calculated NSA incremental costs, the Postal Service carefully evaluated the function-level approximation proposed in this question. That evaluation revealed that the computational difficulties would be substantial, and render an accurate implementation extremely difficult, if not impossible. Moreover, as has been noted previously, the occurrence of the NSA incremental cost calculation at the very tail end of the expanded sequence of activities now required for ACR preparation would make additional complexity particularly difficult to accommodate in the limited time available for this task unless there were a firm basis to expect that any potential improvements in accuracy would truly be material.

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2. Please *see* Attachment, filed under seal.

RESPONSE:

Please see the response filed under seal as part of USPS-RM2018-6/NP1.

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3. Please *see* Attachment, filed under seal.

RESPONSE:

Please see the response filed under seal as part of USPS-RM2018-6/NP1.